

Central Intelligence Agency



Washington, D.C. 20505

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20 DEC 1983

The Honorable William Proxmire
Vice Chairman
Subcommittee on International Trade,
Finance, and Security Economics
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

Your letter of 7 December to the Director raised several questions concerning the article [redacted] that appeared in The Wall Street Journal on 6 December. As you are aware, the article is one of several on Soviet defense spending spawned by the release of our Soviet economics briefing paper by the Joint Economic Committee. Like many of the others, it contains a number of inaccuracies and gives a misleading view of our most recent estimate of Soviet defense spending. Consequently, it does little to clarify the important issues involved.

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One important issue that the article misinterprets is that of the implications our new defense spending estimate has for the Administration's defense policy. The basic thrust of our defense spending testimony was to describe a large and growing Soviet military threat, contrary to the implication [redacted] reached.

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[redacted] basic point is that the CIA estimate of the Soviet burden of defense--currently 13 to 14 percent of GNP--is much too low. He reaches this conclusion because he thinks our estimate of Soviet defense costs is too low and that of Soviet GNP is too high. [redacted] does not, however, seem to fully appreciate conventional Western concepts of economic measurement nor to recognize the wide-ranging sources of data we use and the types of analysis that can be performed with them.

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[redacted] implies, for example, that our defense spending estimate is too low because we cannot measure what we cannot see. In fact, we do account for the costs of many unobservable activities, such as pre-induction training, certain maintenance practices, and command and control facilities. We believe that we are able to make reasonable estimates for such unobservables because our in-depth knowledge of the Soviet military gained over years of research provides a basis for setting reasonable bounds on the levels of these activities.

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Our estimates of Soviet defense costs in dollar or ruble terms are not "an imaginary shaggy dog that the CIA can reshape at will", as [redacted] asserts. As you well know, considerable time and effort is devoted each year to identifying the physical elements of Soviet defense activities and to aggregating them into various cost measures. The doubling of our defense spending estimate in 1976 to which [redacted] alludes was primarily a price phenomenon tied to unanticipated one-time changes in militarily related ruble prices associated with the 1967 price reform. Our current estimate showing no growth in the rate of Soviet military procurement between 1976-81 is based on lower estimates of the quantities of Soviet weapons produced and deployed and thus is not related to any price changes.

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On the GNP side of his argument, [redacted] claims that we cannot accurately calculate Soviet GNP because the official Soviet data we use are deliberately overstated, thus inflating our estimates. Certainly any effort to calculate the GNP of a closed society such as the Soviet Union is very difficult, but it is not impossible. For instance, [redacted] cites the fact that official prices are set by fiat as one reason we cannot calculate Soviet GNP. However, prices set by executive decree are not necessarily invalid for all analytical purposes, especially if one is measuring the level of economic activity as consumers would see it. For other purposes, we have developed adjustments to GNP which better reflect true resource costs. These adjusted GNP estimates are necessary for analysis of the defense burden.

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Moreover, it is not true, as [redacted] alleges that the CIA cannot obtain valid samples of Soviet goods and dollar prices. Over the years we have acquired a large sample of Soviet goods and services and have learned enough about their characteristics to assign accurate comparable dollar costs to them for US-Soviet GNP comparisons. These samples have not been small: a recent comparative study of US-Soviet consumption measured in dollars and rubles used a sample of 334 consumer goods and services, and an earlier study of machinery was based on a 245-item sample.

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[redacted] dismisses official Soviet statistics as useless. Most Western economists, however, do not believe Soviet data to be deliberately biased. Study over many years by well-known Western scholars has concluded that Soviet statistics differ from Western statistics in terms of definition, ideological concepts, and intended use, but not because of deliberate misrepresentation. Soviet data are the only consistent data of sufficient scope to allow detailed structural analysis of the Soviet economy, but, of course, they must be used with care. The accounting practices used by the Soviets to measure physical output must be understood, and Soviet measures of value must be adjusted before comparisons with Western statistics can be made.

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[redacted] goes on to claim that our reports give no descriptions of data sources. On the contrary, recent publications by your committee of CIA estimates of GNP and its components have included extensive explanations of our concepts, methodologies, and sources of data. The only relatively undocumented aspect of GNP accounting in these studies was the military account, for classification reasons.

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The estimate of the burden of defense on the Soviet economy, which is the core of [redacted] criticism, is of course one of the most difficult issues in economic analysis. For this reason, the CIA has spent considerable time and effort developing extensive data bases and highly complex methodologies for attempting to understand the burden question. Our estimating process has been subject to exhaustive review, most recently by separate groups convened by ourselves and the President's Foreign Intelligence Advisory Board. Both reviews strongly supported the analytical integrity of our approach, the thoroughness of our analysis, and the objectivity of its reporting. This is not to suggest, however, that our estimates are without flaws. We are continually striving for improvement.

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The charge in [redacted] article that concerns me most relates to his perception of our unwillingness to carefully consider all sources of information on the Soviet economy. He implies that we do not listen to people who have "been there", but nothing could be further from the truth. We are interested in talking to all individuals who have expertise on the Soviet economy and have frequently supported studies based on their unique insights. Individuals who have had first-hand experience with the Soviet system are a very valuable source of information. Often, however, their analysis of the Soviet economy is viewed through ideologically colored lenses combined with a lack of training in Western economic concepts. Yet, our job as intelligence specialists is to make judgments about the Soviet economy based on many sources of information, including many subjective reports. We will, therefore, continue to exclude no one as a possible source of particular information and general experiences about the Soviet economy. We will also, quite obviously, continue to have some instances where our general analysis fails to confirm the particular impressions of some individuals.

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Sincerely,

/s/ Clair E. George

Clair E. George
Director, Office of Legislative Liaison

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